Filed 4/6/09 Doty v. Superior Court CA2/8

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION EIGHT

FLOYD S. DOTY et al., Petitioners, v. THE SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE COUNTY OF LOS ANGELES, Respondent;	B212420 (Los Angeles County Super. Ct. No. BC 330038)
ALEX MERUELO et al., Real Parties in Interest.	

ORIGINAL PROCEEDING. Petition for extraordinary writ. Alan S. Rosenfield, Judge. Petition affirmed in part; reversed in part.

Ayscough & Marar, Sidney Lanier and Brent Ayscough for Petitioner.

No appearance for Respondent.

Fairbank & Vincent, Dirk L. Vincent and Richard D. Gluck for Real Party in Interest.

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This is the second time that we address the sale of the shares of Doty Bros. Equipment Co. (Doty Bros.) to Meruelo Enterprises, Inc. (Meruelo Enterprises) for $15 million. In *Doty v. Meruelo* (B189961) (*Doty I*), a nonpublished opinion filed on October 16, 2007, we reversed a summary judgment that had been granted in favor of Meruelo Enterprises and remanded with directions. Following the remand of the case, Meruelo Enterprises filed three motions for summary adjudication; the trial court granted all three motions. The plaintiffs filed a petition for an extraordinary writ seeking to set aside all three orders and we issued an order to show cause. We reverse the orders granting summary adjudication as to the causes of action for fraud and rescission and eliminating Jeffrey Hartman as a plaintiff in the eighth cause of action. We affirm the balance of the orders.

FACTS AND PROCEDURAL HISTORY

1. The Facts

This controversy centers on an incentive plan for employees of Doty Bros. that was made part of the sales agreement. As we explained *Doty I*, the stock purchase agreement contained a provision that required Meruelo Enterprises to pay $250,000 in bonuses to key Doty Bros. employees. These bonuses were paid as agreed and this provision therefore plays no role in this litigation. It is the second provision entitled "Performance Award Plan" that is the focal point of the controversy.

Originally, the Performance Award Plan provision of the sales agreement called for Meruelo Enterprises to implement a plan that would be capitalized at a minimum of $750,000. The sales agreement characterized this as a "performance and/or incentive award plan" for the benefit of Doty Bros. employees; we will refer to this plan as the "performance/incentive plan." Under the sales agreement, Meruelo Enterprises was to develop the details of this plan.

Difficulties soon arose in the development of this plan by Meruelo Enterprises. The plan devised by Meruelo Enterprises was based on "performance shares" issued by Meruelo Enterprises that could be cashed for the difference between the value of the "shares" on the date the employee decided to convert into cash and the value of the “shares” on the date of the initial issuance of the “shares.” (We put “shares” in quotes to indicate that these instruments were not common or preferred stock in Meruelo Enterprises but simply instruments of participation in the performance/incentive plan.) Critically important to this scheme was the formula devised for determining the value of these “shares.” The formula used earnings before interest, tax, depreciation and amortization (EBITDA). The performance/incentive plan was to be administered by a committee appointed by Doty Bros.’ board of directors, which had the power to select recipients of the “shares” and to determine the number of “shares” to be issued and the value of the “shares.”

Meruelo Enterprises delivered the performance/incentive plan to the sellers through their attorney, Jeffrey A. Hartman, who was himself to become a litigant in this case. The sellers did not like the plan for various reasons, such as a five-year vesting period and the omission of long-time Doty Bros. employees from the list of award recipients in 2001 and 2002. Negotiations ensued, which culminated in an amendment of the performance/incentive plan that satisfied some of the concerns of the sellers. Importantly, the amendment specifically recognized that the amended performance/incentive plan satisfied the Meruelo Enterprises’ obligation set forth in the underlying sales agreement of Doty Bros. shares.

It turned out that the EBIDTA formula never yielded a positive value for the “shares” issued under the performance/incentive plan. It is of critical importance to this case that the sellers contend that Meruelo Enterprises engaged in a number of deceptive and fraudulent practices for the purpose of ensuring that the “shares” would never have a positive value, thus foreclosing the payment of any portion of the $750,000 to Doty Bros. employees. We set forth the evidence of those fraudulent practices in part 1 of the Discussion of this opinion.

In 2003, the Doty Bros. board of directors terminated the performance/incentive plan and offered holders of these “shares” $0.50 per share in exchange for a release of all claims. Some accepted the offer, others did not. Among those eligible for the offer were 27 persons who neither settled their claim nor brought suit.

2. The Controversy

The gravamen of the controversy is that the sellers of Doty Bros. stock claim that they discounted the price of the stock by $1 million in consideration of the promise by Meruelo Enterprises to pay that sum in benefits to Doty Bros. employees. Specifically, the sellers claim that Meruelo Enterprises promised to pay $250,000 in cash bonuses and use the balance of $750,000 to fund the performance/incentive plan for the benefit of Doty Bros. employees. As we have already noted, it is only the second of these sums that is the subject of this litigation.

3. The First Wave of Litigation in the Trial Courts

The plaintiffs were and continue to be four members of the Doty family,[1] Attorney Hartman, who was a stockholder in Doty Bros., and Dale Barrows, a Doty Bros. employee for nearly 30 years who retired in 2002. The defendants are Meruelo Enterprises, Alex Meruelo, the CEO of this company, and four individuals who are connected with Meruelo Enterprises in various ways and capacities.[2]

The first action was filed by Floyd Doty in federal court. This action was predicated on the Employee Retirement Income Security Act of 1974 (29 U.S.C. § 1001 et seq.) (ERISA) and it named Meruelo Enterprises as a defendant. This action was dismissed because the court concluded that the performance/incentive plan was a "bonus program," was not covered by ERISA and the court therefore lacked jurisdiction to entertain the action.

Immediately after the federal action was dismissed, the sellers[3] and Barrows filed the instant action in state court. The complaint set forth eight causes of action; these

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1 Floyd S., John T., Scott E. and Gary W. Doty sued as trustees of five Doty family trusts.

2 The complaint alleges these individual to be Luis Armona, owner of 7 percent of Meruelo Enterprises stock and an officer of this company; Mario Tapanes, in-house counsel for Meruelo Enterprises; Daniel Occelli, described as the "chief negotiator" for Meruelo Enterprises; and Chris Christy, president of Doty Bros.

3 The sellers were the four members of the Doty family and Attorney Hartman.

were for fraud, promissory fraud, breach of fiduciary duty, constructive fraud, conversion, rescission, constructive trust and breach of contract. The complaint alleged Meruelo Enterprises never funded the performance/incentive plan but instead converted $750,000 for its own use and fraudulently manipulated the valuation of the Doty Bros. shares to find a reason to terminate the plan.

Meruelo Enterprises moved for summary judgment against the sellers and for summary adjudication against Barrows. The motion against the sellers propounded three arguments. First, Meruelo Enterprises argued that, after receiving the original plan and raising their concerns, the sellers entered into a written, integrated agreement, i.e., the amended agreement, in which Meruelo Enterprises agreed to amend the plan and the sellers agreed the plan as amended satisfied the terms of the original agreement; therefore, the parol evidence rule prevented the sellers from contradicting those written terms. Second, because the federal district court determined the sellers were promised no plan other than the plan implemented by Meruelo Enterprises, collateral estoppel prevented the sellers from arguing otherwise. Third, insofar as the sellers' claims were based on Meruelo Enterprises' operation of the plan, the sellers lacked standing because none of them is a plan participant.

In opposition to the motion for summary judgment, the sellers alleged and provided evidence that Meruelo Enterprises engaged in improper conduct in operating the performance/incentive plan and the amended plan, including: failing to fund the plan, computing the value of award shares by an incorrect formula, using fraudulent accountings of company performance, computing the value of award shares by using the incorrect number of Doty Bros. shares, artificially lowering the value of award shares by fraudulent insurance and management fees charged to Doty Bros., allowing appointment of beneficiaries other than Doty Bros. employees, and terminating the amended plan without written consent of the participants.

The trial court granted the motion for summary judgment against the sellers, ruling the parol evidence rule barred their action, that collateral estoppel applied[4] and Meruelo Enterprises had discharged its duty to the sellers for the benefit of third party beneficiary Doty Bros. employees by instituting the amended plan. Judgment was entered for Meruelo Enterprises against the sellers on the complaint. The trial court, however, denied the motion for summary adjudication as to Barrows in part, allowing his action against Meruelo Enterprises to proceed on theories of breach of fiduciary duty, constructive fraud and conversion.

***4. Our Opinion and Decision in* Doty I**

We concluded that the evidence produced by the sellers in opposition to the motion for summary judgment showed "that Meruelo Enterprises engaged in a series of actions that were designed to prevent the amended plan from being activated. If true, these facts show that Meruelo Enterprises acted to frustrate the purpose of the contract." (*Doty I*, *supra*, B189961 [p. 13].) We concluded that this arguably constituted a breach of the covenant of good faith and fair dealing. Accordingly, we reversed and remanded with directions to proceed in conformance with our opinion in *Doty I*.

***5. The Second Wave of Litigation Following* Doty I**

After our decision in *Doty I*, the defendants brought three motions for summary adjudication, which we will refer to as "MSA #1" etc.

In MSA #1, all of the defendants attacked the first seven causes of action, i.e., all the causes of action except the eighth cause of action for breach of contract. MSA #2 sought to eliminate Hartman and all individual defendants except Meruelo Enterprises and Tapanes from the eighth cause of action. MSA #3 was directed at three causes of action asserted by Barrows. These were the causes of action for conversion and for breach of fiduciary duty asserted against Occelli.

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4 We disagreed with this in *Doty I* and found that the judgment in the federal action did not collaterally estop any claim or cause of action in the state action.

The trial court granted all three motions. This left the eighth cause of action for breach of contract asserted by the Doty family members and Barrows, with Hartman eliminated as plaintiff, against Meruelo Enterprises and Tapanes.

We set forth below the trial court's rulings on these motions for summary adjudication.

a. MSA #1

The first and second causes of action are respectively for fraud and for making promises with no intent to perform those promises. The trial court found that the gravamen of these causes of action is that the sellers were promised a plan that is different from the amended performance/incentive plan. The court found that the "principal fraud claim is that they [sellers] were promised a plan that would involve cash payments totaling $750,000." The court concluded that the amended performance/incentive plan did not involve such a cash payment, that the sellers had accepted that plan and that their claims sought to vary the terms of the plan they had accepted. The court concluded that the sellers were relying on inadmissible parol evidence.

The third and fourth causes of action are for breach of fiduciary duty. The court found that parties to a commercial contract do not owe each other fiduciary duties.

The court found that the fifth cause of action for conversion could not be maintained because (1) the sellers were seeking unspecified money damages and conversion therefore could not apply; and (2) an essential element of conversion is that the plaintiff has an ownership right to the personal property in dispute, and this case did not involve such personal property.

The sixth and seventh causes of action were respectively for rescission and a constructive trust. The court found that these are remedies and not causes of action.

b. MSA #2

The court dismissed Hartman as a plaintiff from the eighth cause of action because he was not a party to the underlying sales agreement.

The court dismissed all the defendants other than Meruelo Enterprises and Tapanes from the eighth cause of action for the same reason Hartman was dismissed.

c. MSA #3

This motion addressed only the action brought by Barrows.

The fifth cause of action for conversion was dismissed for the same reason that the court dismissed the conversion cause of action in MSA #1.

The third and fourth cause of action against Occelli was dismissed because Occelli ceased performing any services for Meruelo Enterprises after June 5, 2002.

DISCUSSION

1. Summary Adjudication as to the First and Second Causes of Action Is Reversed

The sellers' fundamental contention is that the Meruelo Enterprises manipulated the EBIDTA formula so as to prevent the "shares" of the performance/incentive plan from acquiring a value sufficient to produce payouts to Doty Bros. employees.

The sellers produced evidence that showed that Meruelo Enterprises, in violation of accepted financial accounting standards, reported that the value of Doty Bros. decreased in the two and a half years after the purchase from $16 million to $6,482,524, a drop of $9,517,476. This was done by a manipulation of the goodwill asset.

Another deceptive and fraudulent device that affected the EBIDTA was the false assumption that there were 10 million shares of common stock, when there were never more than 1000 shares of Doty Bros. stock.

There were fraudulent deductions from profits in the form of deductions for offshore insurance and management fees of nearly $1.8 million per year.

While there is evidence of other fraudulent acts and devices, the foregoing suffices to show that the trial court erred in concluding that the gravamen of the fraud causes of action is that the sellers were promised a performance/incentive plan that was different from the one they actually got. The essence of the fraud claims is that Meruelo Enterprises engaged in fraudulent and deceptive practices that prevented the "shares" of the performance/incentive plan from acquiring sufficient value to require payments to Doty Bros. employees under that plan.

Meruelo Enterprises contends that the sellers' fraud claim is that they were promised a plan that would pay out $750,000 in cash and they were also promised a plan that would allow them to name the beneficiaries but that the plan they got gave them neither of these benefits.[5] Like the trial court, Meruelo Enterprises errs in characterizing the nature of the sellers' fraud claims. The sellers have no quarrel with the performance/incentive plan that Meruelo Enterprises formulated. The sellers contend, pointing to specific evidence of fraudulent and improper practices, that Meruelo Enterprises prevented that plan from operating as it was intended to operate.

Whether the practices identified by the seller were actually fraudulent and improper is of course not the issue on the motion for summary adjudication. At this point, it is a triable issue of fact whether writing down the value of Doty Bros. by over $9 million, as an example, was improper and done with the intent to defraud.

2. The Cause of Action for Restitution Following a Rescission Is Reinstated

The trial court erred in concluding that rescission is only a remedy and is not an "independent cause[] of action."

While the equitable action for a rescission was abolished in 1961, there is now a "legal action for restitution based on a completed unilateral rescission. [Citations, inter alia to Civil Code section 1688 et seq.]" (4 Witkin, Cal. Procedure (5th ed. 2008) Pleading, § 541, p. 668.) Because we have concluded that the sellers may maintain the causes of action for fraud, it is also true that they may seek to rescind the agreement to enter into the (amended) performance/incentive plan based on that fraud. We note that

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5 Meruelo Enterprises states in its brief that it is "unclear" whether the sellers continue to contend that they were promised an ERISA-covered plan and one that was also an express trust but received neither. We do not agree with this observation. We think it is clear that the sellers are not claiming fraud based on the absence of these features from the performance/incentive plan.

the sixth cause of action specifically refers to Civil Code section 1689, subdivision (b)(1), which empowers a party to rescind a contract if consent was obtained by fraud.[6]

We express no view on whether the sellers should recover on the merits of this cause of action. We only hold that the sellers may maintain a cause of action for restitution based on a unilateral rescission.

3. The Complaint May Be Amended to Allege That the Sellers Are Seeking the Imposition of a Constructive Trust

The trial court correctly noted that a constructive trust is a remedy. "The cause of action is not based on the establishment of a trust, but consists of the fraud, breach of fiduciary duty, or other act that entitles the plaintiff to some relief. That relief, in a proper case, may be to make the defendant a constructive trustee with a duty to transfer the property to the plaintiff. [Citations.]" (5 Witkin, Cal. Procedure, *supra*, Pleading, § 840, p. 255.) Thus, predicated on the causes of action for fraud, the sellers may seek the equitable remedy of a constructive trust. Rather than striking all references in the complaint to a constructive trust, the sellers should be given leave to amend the complaint to allege that they are seeking this remedy based on Meruelo Enterprises' fraud.

As with the cause of action for restitution, we express no view on whether the sellers are entitled to the imposition of a constructive trust.

In striking the sixth and seventh causes of action for restitution and a constructive trust, the trial court went on to state that in *Doty I* we held that the only remedy to which the sellers are entitled is specific performance or damages in lieu of specific performance. This is an incorrect interpretation of *Doty I*. We only held that for breach of the covenant of good faith and fair dealing the remedies are specific performance or damages in lieu of specific performance. We did not limit the sellers' action to this single cause of action.

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6 Technically, it may have been preferable to entitle the sixth cause of action "Restitution" rather than "Rescission."

4. Hartman Is Reinstated As a Plaintiff on the Eighth Cause of Action

The trial court struck Hartman as a plaintiff on the eighth cause of action for breach of contract because he was not a signatory of the sales agreement.

Hartman owned 5 percent of Doty stock that was also sold to Meruelo Enterprises under the sales agreement.

Civil Code section 1624, subdivision (a) provides that a contract must be subscribed "by the party to be charged." In *Steel v. Duntley* (1931) 115 Cal.App. 451, 452, the purchaser of real property sued the seller; only the seller had signed the contract of sale. The court held: "One of appellant's premises . . . is that the writing required by the statute must be subscribed by the vendee, the plaintiff in this cause. This is not the requirement of the law. The party to be charged is the only one who must sign, and in the situation before us that is the vendor (who did sign)."

It is also true that Meruelo Enterprises acquired Hartman's 5 percent when it acquired all of Doty Bros. stock. "A voluntary acceptance of the benefit of a transaction is equivalent to a consent to all the obligations arising from it, so far as the facts are known, or ought to be known, to the person accepting." (Civ. Code, § 1589.) "He who takes the benefit must bear the burden." (Civ. Code, § 3521.)

Hartman need not have been a signatory to the sales agreement in order to be a plaintiff on the eighth cause of action for breach of contract.

5. The Balance of the Orders Are Affirmed

We affirm the following orders: (a) Summary adjudication on the third, fourth and fifth causes of action; (2) the order dismissing all the defendants except Meruelo Enterprises and Tapanes in the eighth cause of action; (3) summary adjudication on the cause of action for conversion brought by Barrows; and (4) summary adjudication on Barrows' causes of action against Occelli for breach of fiduciary duties.

We affirm the foregoing orders on the grounds given by the trial court. That is, the third and fourth causes of action for breach of fiduciary duties cannot be maintained between parties to a commercial contract without additional facts, absent here, that a fiduciary relationship existed; and the two causes of action for conversion cannot be maintained because this is an action for monetary damages and not for the return of personal property. The balance of the orders is affirmed for the reasons stated by the trial court.

DISPOSITION

The orders granting summary adjudication (1) on the first and second causes of action for fraud; (2) on the sixth cause of action cause of action for restitution; and (3) as to Hartman as a plaintiff on the eighth cause of action are all vacated and the trial court is directed to enter orders denying these motions. The balance of the summary adjudication orders are affirmed. Petitioners are to be given leave to amend the complaint to seek the imposition of a constructive trust. Petitioners are to recover their costs in these proceedings.

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FLIER, J.

We concur:

RUBIN, Acting P. J.

BAUER, J.*

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* Judge of the Orange Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.